The Tax Adviser

Understanding Qualified Domestic Trusts and Portability

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EXECUTIVE SUMMARY

- U.S. citizens or residents who are married to noncitizen nonresidents should know that their spouse does not generally qualify for the 100% estate tax marital deduction and portability of the deceased spouse's unused estate tax exemption (DSUE amount).
- Property passing to qualified domestic trusts (QDOTs) or passing to a QDOT by irrevocable assignment by a noncitizen spouse before the decedent's estate tax return is filed can qualify for the marital deduction.
- QDOTs are not exempt from estate tax, though, but are merely a means to defer tax. Upon the death of the surviving noncitizen spouse and certain other taxable events, the amounts transferred to a QDOT generally are subject to the Sec. 2056A estate tax. QDOT property is also potentially includible in the surviving spouse's gross estate under other Code provisions (such as Sec. 2044, if the QDOT is also a QTIP).
- Special rules apply for the calculation and use of a noncitizen surviving spouse's DSUE amount. For property passing to a QDOT for a noncitizen surviving spouse, the DSUE amount calculated under the rules applicable to a citizen surviving spouse are subject to adjustments upon final distribution or other termination of the QDOT.
- For a couple with a noncitizen spouse who is likely to be the surviving spouse, careful planning for the use of a QDOT and its interaction with the portability rules can significantly increase the portion of a couple's overall estate that passes to their heirs.

The existence of a noncitizen spouse can significantly change the landscape for federal estate tax purposes. In particular, to qualify for an estate tax marital deduction, a bequest to a noncitizen spouse must meet unique rules. Additionally, the Treasury regulations layer on specific rules that may limit a noncitizen surviving spouse's ability to benefit from portability of an estate's unused estate tax exclusion amount. This article discusses the general rules for the marital deduction in this context and how the general rules are affected by portability and then suggests planning considerations for a client seeking to take advantage of these rules.

Qualified Domestic Trusts

Generally, under Sec. 2056(a), the marital deduction provides a 100% deduction against estate tax for property passing to a decedent's surviving spouse. Each individual also has an estate tax exclusion amount of $5,450,000 ($10,900,000 for a married couple) in 2016. If either spouse is a noncitizen, however, the rules can be turned on their heads. The marital deduction does not typically apply to property passing to a surviving spouse who is not a U.S. citizen.[1]

A nonresident noncitizen (NRNC), absent a treaty provision to the contrary, has a non-inflation-adjusted estate tax credit of $13,000 (equivalent to an exclusion of $60,000) that applies against any estate tax on his or her property situated in the United States.[2] Finally, a noncitizen spouse may not be able to use the deceased spouse's unused exemption amount (DSUE amount), colloquially referred to as "portability," or the portability rules may limit the use of the DSUE amount.

In the context of the marital deduction, estate plans involving a noncitizen[3] spouse must carefully consider the following concepts. First, property passing to a trust that qualifies as a qualified domestic trust (QDOT) for the benefit of the noncitizen surviving spouse, or passing directly to the noncitizen surviving spouse who then irrevocably assigns the property to a QDOT before the deceased spouse's estate tax return is due (including extensions), does qualify for the marital deduction.[4] Second, if the noncitizen surviving spouse becomes a U.S. citizen before the time required to file the deceased spouse's estate tax return, and at all times after the deceased spouse's death and before becoming a citizen the surviving spouse was a resident of the United States, then the transfer of property from the deceased spouse to the noncitizen surviving spouse does qualify for the marital deduction.[5] Third, a treaty may allow a credit in lieu of the marital deduction[6] or may allow a marital deduction.[7] Lastly, if the noncitizen surviving spouse dies and his or her estate is subject to estate tax, then estate taxes paid by the first deceased spouse on property included in the surviving spouse's gross estate may generate a credit against the surviving spouse's estate tax under Sec. 2013 (discussed below).[8]

Technical QDOT Requirements

To be a QDOT, a trust agreement[9] must:

1. Provide that the laws of a U.S. state or the District of Columbia govern its administration;

2. Qualify as an ordinary trust under Regs. Sec. 301.7701-4(a);

3. Have terms that qualify it as a power of appointment trust, a qualified terminable interest property trust (QTIP trust), a qualified charitable remainder trust (qualified CRT), or an estate trust;[10]

4. Require at least one trustee to be a U.S. citizen or a U.S. corporation (i.e., a corporation created or organized under the laws of a U.S. state or the District of Columbia);[11] and

5. Provide that no distributions (except distributions of income) may be made from the trust unless the trustee has the right to withhold the Sec. 2056A estate tax (discussed below); and

   a. Provide that if the property transferred to the QDOT has a value that exceeds $2 million (based on the values finally determined for estate tax purposes and ignoring any indebtedness on the property) at least one trustee must be a U.S. bank, the trustee must post a bond with the IRS equal to 65% of the fair market value of the property transferred to the trust, or the trustee must furnish the IRS with a letter of credit of 65% of the fair market value of the property transferred to the trust; and

   b. Provide that if the property transferred to the QDOT has a value that is $2 million or less (based on the values finally determined for estate tax purposes and ignoring any indebtedness on the property), then either no more than 35% of the trust property determined annually on the last day of the trust's tax year will consist of foreign real property, or the trust will meet the bank, bond, or letter of credit rules above.[12]

In addition to these requirements, the deceased spouse's executor must make a QDOT election on the deceased spouse's timely filed estate tax return (including extensions) or, if not timely filed, on the deceased spouse's first-filed estate tax return, provided it is filed within one year of the date the estate tax return was due.[13]

Property funded into the QDOT generally must pass from the deceased spouse. However, if the property first passes from the deceased spouse to the surviving spouse and the surviving spouse transfers or irrevocably assigns the property to the QDOT, the surviving spouse's receipt of which would qualify for the marital deduction but for his or her noncitizen status, and the assignment occurs before the deceased spouse's estate tax return is filed, the transfer of those assets to the surviving spouse (and ultimately to the QDOT) does qualify for the marital deduction.[14] In that case, the trust does not have to meet the requirements of a power of appointment trust, a QTIP trust, a qualified CRT, or an estate trust.[15] Instead, the trust must meet requirements 4 and 5 above,[16] and the executor must still make the QDOT election. The surviving spouse does not need to be a beneficiary of the trust.

The surviving spouse is treated as the transferor of the property in the trust for all other purposes except the QDOT rules and the special valuation rules of Chapter 14.[17] If the surviving spouse transfers all of his or her interest in the property to the QDOT, then the surviving spouse is also not treated as the transferor if the QDOT would have received the property had the surviving spouse executed a qualified disclaimer.[18]

Other rules may save transfers that otherwise do not qualify for the marital deduction. For example, nontransferrable assets (e.g., qualified retirement plans or annuities) that would qualify for the marital deduction but for the surviving spouse being a noncitizen may be treated as assigned to and part of the QDOT property if certain requirements are met.[19] Also, a trust that does not qualify as a QDOT may be reformed under the provisions of the deceased spouse's will or trust or under a court ordered reformation, so long as the reformation of the will or trust is completed by the time the deceased spouse's estate tax return is due (including extensions), or the judicial reformation proceeding is commenced by the time the deceased spouse's estate tax return is due (determined with regard to extensions actually granted).[20] Whether a trust qualifies (or will qualify by reformation) as a QDOT is ultimately determined on the due date of the deceased spouse's estate tax return, or, if a judicial proceeding is commenced on or before the due date (determined with regard to extensions) for filing that return to change the trust into a QDOT, as of the time when the changes pursuant to that proceeding are made.[21]

Sec. 2056A Estate Tax on QDOT Distributions

The QDOT rules allow transfers from a deceased spouse to qualify for the marital deduction, but it is a deferral and not an exemption from estate tax. A QDOT is subject to the Sec. 2056A estate tax. The Sec. 2056A estate tax is the estate tax that would have been imposed on the deceased spouse's estate if the amount of the taxable event (defined below) and all prior taxable events had been included in the deceased spouse's gross estate, reduced by the estate tax that would have been imposed on the deceased spouse's estate if only amounts from prior taxable events had been included in the deceased spouse's gross estate.[22] Accordingly, it is deemed a tax on the deceased spouse's estate[23] and is determined using the estate tax rates in effect on the date of the deceased spouse's death.[24]

A "taxable event" means (1) a distribution from the QDOT before the surviving spouse's death, (2) the surviving spouse's death,[25] or (3) the trust's failure to qualify as a QDOT.[26] The Sec. 2056A estate tax is imposed on (1) the value of the distribution, in the case of a distribution during the surviving spouse's lifetime; (2) the value of the trust property on the date of the surviving spouse's death, in the case of the death of the surviving spouse; or (3) the value of the trust property on the date the trust ceases to qualify as a QDOT.[27] A "taxable event" does not include distributions of income, distributions of corpus made on account of a hardship, and miscellaneous distributions or dispositions (e.g., ordinary and necessary expenses of the trust, tax payments on the trust's tax liabilities (other than the Sec. 2056A estate tax), or sales of trust property for full and adequate consideration).[28]

"Income" means fiduciary accounting income, not taxable income.[29] Income does not include capital gains or any other item that would be allocated to corpus under the applicable local law (ignoring any special trust provisions to the contrary).[30] If payments are made as a unitrust amount approved by local law, they may be considered income if local law defines the payments as income.[31] A unitrust amount treated as income under local law may also be treated as income for purposes of the surviving spouse's income interest in a QTIP trust or a power of appointment trust.[32] Also, items allocated to income under applicable local law allowing the trustee to reasonably apportion income and principal to fulfill the trustee's duty of impartiality generally are treated as income.[33] Income does not include items constituting income in respect of a decedent unless it is allocable to income under an applicable unitrust statute or principal and income allocation statute discussed above, though distributions from a qualified retirement plan or IRA paid in the form of an annuity may be allocated between income and principal.[34]

Distributions from corpus are made on account of a hardship if made "in response to an immediate and substantial financial need relating to the spouse's health, maintenance, education, or support" or those needs for a person the surviving spouse is legally obligated to support.[35] No distribution is treated as for hardship if the surviving spouse has other sources reasonably available to pay the amount.[36] The regulations state that closely held business interests, real estate, and tangible personal property are not considered reasonably available to the surviving spouse.[37] Publicly traded stock or certificates of deposit, on the other hand, are considered reasonably available.[38]

The Sec. 2056A estate tax will not apply under two circumstances if the surviving spouse becomes a U.S. citizen (collectively the "U.S. citizenship exceptions").[39] The first exception occurs if the surviving spouse was a resident of the United States at all times from the date of the deceased spouse's death until the surviving spouse becomes a citizen, or, if no taxable event occurred before the surviving spouse becomes a citizen, regardless of residency.[40] If those conditions are met, the trustee also must notify the IRS of the surviving spouse's citizenship on a final and timely filed Form 706-QDT, *U.S. Estate Tax Return for Qualified Domestic Trusts*.[41]

The second exception occurs if the surviving spouse cannot meet the first option. Here, the Sec. 2056A estate tax would cease to apply if the surviving spouse becomes a U.S. citizen and elects (1) to treat all taxable event distributions as gifts for purposes of his or her adjusted taxable gifts under Sec. 2001(b)(1)(B) and as gifts under Sec. 2501, and (2) to treat a reduction in the Sec. 2056A estate tax by reason of the deceased spouse's unified credit as a reduction in the surviving spouse's unified credit.[42] This second option also requires an election on a timely filed Form 706-QDT.[43]

Each trustee of the QDOT is personally liable to pay the Sec. 2056A estate tax.[44] If there are multiple QDOTs, then a trustee is liable for the tax on the QDOT for which the trustee serves.[45] In addition, the trustee may be liable as a withholding agent on any trust distributions.[46] Taxable events and hardship distributions qualifying for exemption are reported annually on Form 706-QDT, filed on April 15 of the following year, with a six-month extension upon request.[47]

Inclusion of QDOT Property in Surviving Spouse's Gross Estate

When the surviving spouse dies, in addition to a potential taxable event triggering Sec. 2056A estate tax, the QDOT property may be includible in the surviving spouse's gross estate under the following Code provisions:

- Under Sec. 2044 because the QDOT was also a QTIP trust;
- Under Sec. 2041(a)(2) because the QDOT was a power of appointment trust that granted the surviving spouse a general power of appointment;
- Under Sec. 2033 because the QDOT was an estate trust and payable to the surviving spouse's estate;
- Under Sec. 2039 because the surviving spouse owned a nonassignable asset (such as an IRA or other qualified retirement plan); or
- Under Sec. 2035, 2036, 2037, 2038, or 2042 because the surviving spouse created the QDOT and retained powers (or released the powers) described in those sections.

These principles apply to an NRNC spouse to the extent the property is situated in the United States.[48] If the surviving spouse is an NRNC, then even QDOT property situated outside of the United States at the time of the surviving spouse's death would be included in the surviving spouse's estate if the surviving spouse created the QDOT after the deceased spouse's death and, in the process of creating the QDOT, the surviving spouse made a transfer of property situated in the United States, and the transfer is described in Sec. 2035, 2036, 2037, or 2038.[49]

When the QDOT property is included in the surviving spouse's gross estate, the surviving spouse's estate is entitled to the benefits of the credit for foreign death taxes (Sec. 2014), the six-month alternate valuation date (Sec. 2032), special-use valuation under Sec. 2032A, charitable deductions under Sec. 2055, the marital deduction under Sec. 2056, the deduction for state death taxes under Sec. 2058, and extensions of time to pay estate taxes under Sec. 6161(a)(2) and Sec. 6166 as if the surviving spouse were a U.S. citizen or resident (if he or she is not already one) for purposes of calculating the Sec. 2056A estate tax.[50]

In addition, the surviving spouse's estate is entitled to a credit for estate taxes previously paid (by the deceased spouse as Sec. 2056A estate tax) for up to 10 years from the deceased spouse's death under Sec. 2013.[51] Unlike for other individual taxpayers, however, the Sec. 2013 credit for the Sec. 2056A estate tax is not subject to being phased out over the 10-year period, but it is limited to the smaller of (1) the aggregate of the Sec. 2056A estate tax on all taxable events (during life and at death) or (2) the difference between the estate tax on the surviving spouse's taxable estate (including the QDOT property) and the estate tax on the surviving spouse's taxable estate (excluding the QDOT property).[52]

Since the first limitation looks to the deceased spouse's estate and the second limitation looks to the surviving spouse's estate, the nature of other available deductions or credits available to either spouse's estate may have an effect on the level of the relative limitations. This also means that if the deceased spouse's taxable estate is not large enough to be subject to Sec. 2056A estate tax, then no Sec. 2013 credit is available to the surviving spouse. Under Regs. Sec. 20.2056A-7(b), property passing to a noncitizen surviving spouse that was not subject to a QDOT election is also eligible for the Sec. 2013 credit, without a phaseout, for up to 10 years after the deceased spouse's death.

Portability and QDOTs

Special rules apply in computing and using the DSUE amount of a noncitizen surviving spouse. When property passes to a QDOT, the DSUE amount is initially computed in the same manner as when property passes to a citizen spouse; however, it is subject to subsequent adjustments upon final distribution or other termination of the QDOT. The adjustments reduce the DSUE amount by the value of the QDOT property remaining at the time the QDOT is terminated by a final distribution or the value of the QDOT property on the death of the surviving spouse "on which estate tax is imposed under section 2056A."[53]

Consequently, due to the adjustment rules, if the QDOT property's value is the same or more than the DSUE amount, the surviving spouse would not be entitled to use any DSUE amount. If a QDOT is used, the DSUE amount is only likely to be available if the deceased spouse's estate and the QDOT property's value are both relatively small or the surviving spouse meets one of the U.S. citizenship exceptions. If the surviving spouse meets one of the U.S. citizenship exceptions, the DSUE amount is available to the surviving spouse without further adjustment as of the date he or she becomes a U.S. citizen.[54]

A noncitizen surviving spouse is not permitted to apply the DSUE amount to make gifts subsequent to the deceased spouse's year of death and while a QDOT is in effect. This is an exception to the ordering rules in the regulations that provide any gifts of the surviving spouse are first applied against the surviving spouse's DSUE amount and second against the surviving spouse's own federal gift tax exclusion amount.[55] Any DSUE amount remaining after termination of the QDOT and adjustment to the DSUE amount may be applied to the surviving spouse's gifts made in the year the QDOT terminates (whether by death or otherwise).[56] If the surviving spouse meets one of the U.S. citizenship exceptions, however, the DSUE amount is available to the surviving spouse without further adjustment as of the date he or she becomes a U.S. citizen.[57]

An NRNC surviving spouse may not take into account the DSUE amount, except to the extent allowed under a treaty.[58] It would be wise, however, for an executor to elect portability when available, in case an NRNC surviving spouse becomes a U.S. citizen, is a U.S. resident at the time of death or a gift, or is or becomes a resident of a country with a treaty that would allow the DSUE amount to be included in the surviving spouse's estate tax or gift tax exclusion amount.[59] Portability also does not apply, and is therefore unavailable, to the estate of an NRNC deceased spouse.[60]

Planning With QDOTs and Portability

Selecting an appropriate plan that involves a noncitizen spouse means first understanding which of the many rules apply. The exhibit illustrates the nine planning scenarios that a married couple may fall into, each with its own possible outcomes. Within each planning scenario, different estate planning techniques can lead to varying results. Since clients or their property sometimes change residency, the appropriate scenario may change with time.

Exhibit: Planning scenarios for married couples

If decedent is a:	And the surviving spouse is a:		
	U.S. citizen	U.S. resident (noncitizen)	Nonresident noncitizen
U.S. citizen	• $5.45 million exclusion* • Unlimited marital deduction	• $5.45 million exclusion • No marital deduction • QDOT deferral • Potential treaty benefits	• $5.45 million exclusion • No marital deduction • QDOT deferral • Potential treaty benefits
U.S. resident (noncitizen)	• $5.45 million exclusion • Unlimited marital deduction	• $5.45 million exclusion • No marital deduction • QDOT deferral • Potential treaty benefits	• $5.45 million exclusion • No marital deduction • QDOT deferral • Potential treaty benefits
Nonresident noncitizen	• $60,000 exclusion • Unlimited marital deduction	• $60,000 exclusion • No marital deduction • QDOT deferral • Potential treaty benefits	• $60,000 exclusion • No marital deduction • QDOT deferral • Potential treaty benefits

* Estate tax exclusion amount for 2016

While conventional planning techniques today often focus on income tax savings, estate tax savings are the driver of QDOT planning. For example, some commentators suggest that under the current high-income-tax environment, a good plan may be to leave the deceased spouse's property in a QTIP trust for the surviving spouse.[61] The surviving spouse could then use the deceased spouse's DSUE amount to shelter the QTIP trust property from estate taxes at the surviving spouse's death, and also the QTIP trust property receives a new income tax basis, eliminating any built-in capital gains. While property in a QDOT that qualifies as a power of appointment trust, a QTIP trust, or an estate trust would likely qualify to receive a new income tax basis at the surviving spouse's death, because of the portability rules related to NRNC deceased spouses and QDOTs, it is more likely that the utility of a QDOT is to defer the deceased spouse's estate tax rather than to save income tax or estate tax at the surviving spouse's death.

The examples below illustrate just two of the nine scenarios from the exhibit but show how changes to the planning techniques can result in different outcomes. Except where specified, the examples are based on these common facts: The first deceased spouse is a U.S. citizen who died in 2015, when the estate tax exclusion amount was $5,430,000. The value of the first deceased spouse's gross estate is $10 million, and it has administrative expenses of $100,000. The surviving spouse (a noncitizen resident of the United States who never becomes a U.S. citizen) has his or her own property equal to $10 million at the date of the first deceased spouse's death, and all property (inside or outside of trusts) appreciates at a 5% rate after the first deceased spouse's death.

Neither spouse has made any taxable gifts during life. All tax rates and exclusion amounts remain constant at their 2015 figures. Neither spouse is subject to state or foreign estate or inheritance taxes. Neither spouse is eligible for credits other than those associated with the estate tax exemption amount (such as credits for foreign taxes paid or credits allowed under a treaty). The surviving spouse survives for five years after the first deceased spouse's death without remarrying, and the surviving spouse's estate also has administrative expenses of $100,000. Any QDOT also qualifies as a QTIP trust. At the surviving spouse's death, no generation-skipping transfer taxes apply.

> ***Example 1:*** If the property of the first deceased spouse passes outright to the surviving spouse and never into a QDOT, then the first deceased spouse's estate tax would be $1,788,000. At the surviving spouse's death, he or she would have a gross estate worth $23,116,012. The tax on the surviving spouse's estate would be $5,246,405, after applying the unified credit and the Sec. 2013 credit for estate tax paid on the first deceased spouse's estate. The couple would pass $17,769,607 to heirs after administrative expenses and estate taxes, or 77.21% of their wealth (i.e., $17,769,607 ÷ $23,016,012).

Example 1, therefore, demonstrates what the result would be with no planning. Because of the Sec. 2013 credit and the rule of Regs. Sec. 20.2056A-7(b) (which allows the noncitizen surviving spouse to use the Sec. 2013 credit without the percentage reductions under Sec. 2013(a)), the couple can still transfer a significant amount of wealth to their heirs.

> ***Example 2:*** If the first deceased spouse leaves all of his or her estate, after administrative expenses, in a QDOT for the surviving spouse, then at the surviving spouse's death, the value of the surviving spouse's gross estate, including the QDOT, would be $25,398,003 (consisting of $12,762,816 of his or her own property and $12,635,187 of QDOT property). Although the first deceased spouse used none of his or her estate tax exclusion, the surviving spouse is not entitled to any DSUE amount because the DSUE amount is adjusted down to zero by the value of the QDOT property at the date of the surviving spouse's death. The QDOT property is subject to Sec. 2056A estate tax of $2,882,075, and the surviving spouse's taxable estate is subject to estate tax of $5,065,126 (total Sec. 2056A estate tax and estate tax of $7,947,201). After taxes and administrative expenses, $17,350,802 passes to the couple's heirs, or 68.59% of their wealth (i.e., $17,350,802 ÷ $25,298,003).

Thus, Example 2 demonstrates that deferring estate taxes on the first deceased spouse's estate, by leaving the entire estate in a QDOT, does not necessarily result in a lower estate tax outcome than doing no planning at all. This result stems from the inclusion in the surviving spouse's estate of both the full value of the first deceased spouse's net estate (undiminished by estate taxes at the first death) and the appreciation on the amount of estate tax that otherwise would have been paid at the first death. The result in Example 2 could likely be improved by planning to reduce the value of the QDOT after the first deceased spouse's death.

> ***Example 3:*** The result in Example 2 may be significantly improved by using the deceased spouse's estate tax exclusion amount of $5,430,000 to fund a bypass trust and leaving only the remaining amount of $4,470,000 in a QDOT. In that case, at the surviving spouse's death the value of the surviving spouse's gross estate, including the QDOT, would be $18,467,795 (consisting of $12,762,816 of his or her own

property and $5,704,979 of QDOT property). The bypass trust would be worth $6,930,209 at the date of the surviving spouse's death. The surviving spouse is not entitled to any DSUE amount because the first deceased spouse's estate tax exclusion was used on the bypass trust. The QDOT property is subject to a Sec. 2056A estate tax of $2,281,992, and the surviving spouse's taxable estate is subject to estate tax of $2,893,126 (total Sec. 2056A estate tax and estate tax of $5,175,118). After taxes and administrative expenses, an aggregate of $20,122,885 passes to the couple's heirs, or 79.54% of their wealth (i.e., $20,122,885 ÷ [$18,467,794 + $6,930,209 – $100,000]).

The results can be even further improved if the surviving spouse is an NRNC who does not own property situated in the United States.

Example 4: Assume the same facts as Example 2—but the surviving spouse is an NRNC with $10 million of property (as of the first deceased spouse's death) not situated in the United States for estate tax purposes, and who never becomes a U.S. citizen or resident (for estate tax purposes)—then at the surviving spouse's death the value of the surviving spouse's gross estate would include only the QDOT property of $12,635,187. The surviving spouse is not entitled to a DSUE amount because he or she is an NRNC. The QDOT property is subject to a Sec. 2056A estate tax of $2,882,075, and the surviving spouse's gross estate is subject to estate tax of $2,064,800 (total estate tax and Sec. 2056A estate tax of $4,946,875). The surviving spouse's non-U.S. situs assets would be worth $12,762,816 at his or her date of death. After taxes and administrative expenses, an aggregate of $20,351,128 passes to the couple's heirs, or 80.45% of their wealth (i.e., $20,351,128 ÷ [$12,635,187 + $12,762,816 – $100,000]).

This example demonstrates how the surviving spouse could improve the tax results if he or she does not plan to be domiciled in the United States at his or her date of death. If that is the case, then changing domicile outside of the United States and moving (or keeping) property outside of the estate tax's reach can shelter more wealth for the couple's heirs, assuming there are no foreign estate or inheritance taxes to pay.

Finally, to take advantage of the first deceased spouse's DSUE amount, the value of the QDOT must be less than the value of the DSUE amount at the first deceased spouse's death. Therefore, it will likely only be possible to use the DSUE amount if the first deceased spouse has a nontaxable estate or if the first deceased spouse elects to use some (but not all) of his or her estate tax exemption amount to shelter his or her estate from estate taxes.

Example 5: Assume the same facts as Example 2, but the first deceased spouse's estate only has $1 million in value and the surviving spouse's property is valued at $19 million at the time of the first deceased spouse's death. At the surviving spouse's death, the value of the surviving spouse's gross estate, including the QDOT, would be $25,398,003 (consisting of $24,249,350 of his or her own property and $1,148,653 of QDOT property). The surviving spouse would be entitled to a DSUE amount of $4,281,347 (an adjustment from $5,430,000 by the value of the QDOT property on the surviving spouse's date of death). The QDOT property is not subject to a Sec. 2056A estate tax (because the first deceased spouse's estate tax exemption amount exceeds the value of the QDOT property), and the surviving spouse's taxable estate is subject to estate tax of $6,234,663. After taxes and administrative expenses, $19,063,340 passes to the couple's heirs, or 75.36% of their wealth (i.e., $19,063,340 ÷ $25,298,003). Note that growth in the QDOT value led to a decrease in the DSUE amount that might otherwise have been available had the QDOT not been used.

Conclusion

As these examples demonstrate, the appropriate planning technique depends on the facts and circumstances, and reasonable assumptions, of each client's situation. There is no one-size-fits-all plan. Therefore, the client's professional advisers will need to carefully analyze the potential outcomes of each plan to truly determine which can be expected to result in the least amount of tax.

Footnotes

[1]Sec. 2056(d)(1)(A).

[2]See Sec. 2102(b)(1).

[3]Estate tax rules for U.S. residents and U.S. citizens should be distinguished from the income tax rules for nonresidents.

[4]Sec. 2056(d)(2).

[5]Sec. 2056(d)(4).

[6]See, e.g., Protocol Amending the Convention With Respect to Taxes on Income and on Capital, U.S.-Canada, art. XXIX B (April 24, 1995) (allowing a credit).

[7]See Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Estates, Inheritances, Gifts and Certain Other Transfers, U.S.-Denmark, art. 9(2) (April 27, 1983); Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion Wth Respect to Taxes on Estates, Inheritances, and Gifts, U.S.-France (Nov. 24, 1978), art. 11(3), as amended by Protocol (Dec. 8, 2004); Convention for the Avoidance of Double Taxation With Respect to Taxes on Estates, Inheritances, and Gifts, U.S.-Germany (Dec. 3, 1980), art. 10(6), as amended by Protocol (Dec. 14, 1998); Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Estates of Deceased Persons and Gifts, U.S.-United Kingdom (Oct. 19, 1978), art. 8(2).

[8]Sec. 2056(d)(3).

[9]Some jurisdictions allow trusts to be created without a formal trust agreement. See Uniform Trust Code Sections 401 and 407.

[10]These trusts qualify for the terminable interest exception described in Sec. 2056(b). Generally, property left in trust to a spouse does not qualify for the marital deduction absent meeting one of these exceptions.

[11]Note that under Regs. Sec. 301.7701-7, the trust could be a foreign trust for income tax and reporting purposes if the primary supervision of a court is not in the United States or a U.S. person does not have authority to control all substantial decisions of the trust.

[12]Sec. 2056A(a)(1); Regs. Secs. 20.2056A-2(a) through (d). The executor may exclude up to $600,000 of the value of a residence and related furnishings owned by the trust and used by the surviving spouse as a personal residence from the $2 million calculation (Regs. Sec. 20.2056A-2(d)(1)(iv)).

[13]Secs. 2056A(a)(3) and 2056A(d); Regs. Sec. 20.2056A-3(a).

[14]Sec. 2056(d)(2)(B).

[15]See Regs. Sec. 20.2056A-2(b).

[16]Id.

[17]Regs. Secs. 20.2056A-4(b)(5) and 25.2702-1(c)(8).

[18]See Sec. 2518(c)(3); Regs. Sec. 20.2056A-4(b)(5).

[19]Regs. Secs. 20.2056A-2(b)(3) and 20.2056A-4(c).

[20]Sec. 2056(d)(5)(A); Regs. Secs. 20.2056A-4(a)(1) and (2).

[21]Sec. 2056(d)(5)(A).

[22]Sec. 2056A(b)(2)(A).

[23]Sec. 2056A(b)(7).

[24]Regs. Sec. 20.2056A-6(a).

[25]Sec. 2056A(b)(9).

[26]Regs. Sec. 20.2056A-5(b)(3).

[27]Secs. 2056A(b)(1) and (4).

[28]Regs. Sec. 20.2056A-5(c).

[29]Regs. Sec. 20.2056A-5(c)(2).

[30]Id.

[31]See Regs. Secs. 1.643(b)-1 and 20.2056A-5(c)(2). Thirty-six states have passed statutes that either expressly allow for the conversion of a trust to a unitrust or govern the allocation of income to the unitrust amount. See Ala. Code §19-3A-106; Alaska Stat. §13.38.300; Ariz. Rev. Stat. §14-11014; Cal. Prob. Code §16336.4; Colo. Rev. Stat. §15-1-404.5; Del. Code tit. 12, §61-106; Fla. Stat. §738.1041; Ga. Code §53-12-362; 760 Ill. Comp. Stat. 5/5.3; Ind. Code §30-2-15-9; Iowa Code §637.602; Kan. Stat. §58-9-105; Ky. Rev. Stat. §386.454; Me. Rev. Stat. tit. 18-A, §7-705; Md. Code, Est. & Trusts §15-502.1; Mo. Rev. Stat. §469.411; Neb. Rev. Stat. §30-3119.01; Nev. Rev. Stat. §164.796; N.H. Rev. Stat. §564-C:1-106; N.M. Stat. §46-3A-105; N.Y. Est. Powers & Trusts Law §11-2.4; N.C. Gen. Stat. §37A-1-104.2; Or. Rev. Stat. §129.225; 20 Pa. Cons. Stat. §8105; R.I. Gen. Laws §18-4-29; S.C. Code §62-7-904C; S.D. Codified Laws §55-15-2; Tenn. Code §35-6-108; Tex. Prop. Code §116.007; Utah Code §22-7-103; Vt. Stat. tit. 14A, §907; Va. Code §64.2-1003; Wash. Rev. Code §11.104A.040; W. Va. Code §44B-1-104a; Wis. Stat. §701.1106; Wyo. Stat. §2-3-903.

[32]See Regs. Secs. 1.643(b)-1; 20.2056(b)-5(f)(1); 20.2056(b)-7(d)(1) and (2); see also IRS Letter Ruling 201148001 (ruling that a QTIP that was to be converted to a total return unitrust that met the requirements of Regs. Sec. 1.643(b)-1 would continue to qualify as a QTIP).

[33]Regs. Sec. 20.2056A-5(c)(2).

[34]Id.; see also IRS Letter Ruling 9746049 (holding that if distributions from an IRA are not in the form of an annuity, they are allocated between income and principal as if the IRA were a trust).

[35]Regs. Sec. 20.2056A-5(c)(1).

[36]Id.

[37]Id.

[38]Id.

[39]See Sec. 2056A(b)(12).

[40]Regs. Sec. 20.2056A-10(a)(1).

[41]Regs. Sec. 20.2056A-10(a)(2).

[42]Regs. Secs. 20.2056A-10(b)(1) and (2).

[43]Regs. Sec. 20.2056A-10(b)(3).

[44]Regs. Sec. 20.2056A-11(d).

[45]Id.

[46]Regs. Secs. 1.1441-5(b)(2) and 20.2056A-11(d); Temp. Regs. Sec. 1.1441-5T(b)(2)(iii).

[47]Regs. Secs. 20.2056A-5(c)(1) and 20.2056A-11.

[48]Regs. Sec. 20.2103-1.

[49]See Sec. 2104(b); Regs. Sec. 20.2104-1(b); Technical Advice Memorandum 9507044.

[50]Sec. 2056A(b)(10).

[51]Sec. 2056(d)(3); Regs. Secs. 20.2056A-7(a) and (c).

[52]See id.

[53]Regs. Sec. 20.2010-2(c)(5), Example (3); Regs. Sec. 20.2010-2(c)(4).

[54]Regs. Sec. 20.2010-2(c)(4)(ii).

[55] Regs. Sec. 25.2505-2(b).

[56] Regs. Sec. 25.2505-2(d)(3)(i).

[57] Regs. Sec. 25.2505-2(d)(3)(ii).

[58] Sec. 2102(b)(3)(A); Regs. Sec. 20.2010-3(e).

[59] See Regs. Secs. 20.2010-3(e) and 25.2505-2(f).

[60] Regs. Sec. 20.2010-2(a)(5).

[61] See Blattmachr, Bramwell, and Zeydel, "Portability or No: The Death of the Credit-Shelter Trust?" 118-5 *J. Tax'n* 232 (May 2013); see also Rev. Proc. 2016-49 (permitting a QTIP election for portability purposes even if the election is not necessary to reduce estate tax of the first deceased spouse).

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